

# Pension Obligation Bonds



## The Good, The Bad and The Ugly

*September 12, 2004*

*Jay M. Goldstone  
Director of Finance  
City of Pasadena  
(626) 744-4350*

**City of Pasadena**

# System Overview

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## City of Pasadena Fire and Police Retirement System (FPRS)

- ◆ System Closed in 1977
- ◆ 46 Active Members
- ◆ Approximately 345 Retirees/Beneficiaries
- ◆ Present Value of Projected Benefits
  - \$223 Million
- ◆ Market Value
  - \$61.2 Million (Actual)

# FPRS Overview (Cont.)

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- ◆ Five Member Governing Board
  - Three appointed by the City Council
  - One each elected by Police and Fire
- ◆ Estimated Annual Beneficiary Payments
  - \$13 to \$14 Million
- ◆ Annual Contributions from City
  - Based upon a Contribution Agreement

# The Problem

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- ◆ A closed System which was less than 30% funded
- ◆ History of Tension between the City and the Board
- ◆ Draining City resources
- ◆ Slow funding of the System
- ◆ Relying too heavily on investment earnings
- ◆ The feeling of broken promises

# The Goal

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- ◆ Provide a needed infusion of cash into the System to improve funding ratio
- ◆ Save the City money
- ◆ Improve relationships

# The Good

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- ◆ Along Comes 1999
- ◆ Negotiated a Supplemental Contribution Agreement
  - Benchmarked/defined various assumptions
  - Established more objective methodology for calculating future contributions
  - Absolutely saved the City money
  - Provided \$100 Million to the System, bringing total asset value to approximately \$170 Million (82% funded)

# Pension Obligation Bonds

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- ◆ SB481 – The Pasadena Solution
- ◆ Two Series of \$50 Million Each
- ◆ Series A – Fully Amortized – 2014
- ◆ Series B – Interest Only – 2014
  - Call Option
- ◆ Excess Tax Increment to be used to retire Series B
- ◆ Proceeds invested per existing asset allocation (50% Stocks/50% Bonds)

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**LIFE IS GOOD** – End of Story

(NOT)

# The Bad

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## The City did save money, but...

- ◆ Changing Market Conditions/Poor Investment Performance – lost \$25-\$30 Million
- ◆ Improved Benefits – Keeping up with PERS
- ◆ Obligations do not go away
- ◆ Unanticipated changes in the Industry

# The Ugly

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- ◆ Unilateral change in calculating market related value
- ◆ Underperformed benchmarks
- ◆ Independence of the Retirement Board and deteriorating relationships
- ◆ City still footing the bill
- ◆ Potential lawsuit
- ◆ More negotiations

# Where Are We In 2004?

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- ◆ 6 Active Members
- ◆ Approximately 325 Retirees/Beneficiaries
- ◆ Present Value of Future Liability
  - \$199 Million
- ◆ Market Value
  - \$122 Million (Actuarial) \$104 Million (Actual)
- ◆ City Required Supplemental Contribution

# Here We Go Again

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## ◆ Second POB Just Completed: Private Placement with DEPFA

- \$40 Million of Net Proceeds
- Variable Rate tied to 1 Month LIBOR
- Matures May 2015
- Extremely Flexible Terms
  - Ability to fund incrementally
  - Modest minimum annual payments
  - Option to pre-pay without penalties
  - Balloon payment in 2015

# Watch Out

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## ◆ Pension Obligation Bonds:

- Serve a purpose
- Are not a panacea
- Analyze cashflow
- Analyze investment performance
- Trading one debt for another
  - You lose some degree of flexibility

# Watch Out (cont'd)

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- ◆ POB issuance is a form of risk arbitrage
  - Failure to earn the assumed investment rate will lead to a new unfunded liability on top of the POB debt
  - Overperformance can lead to superfunding and can unnecessarily tie up assets
- ◆ Understand what you are doing as well as the consequences and the particular dynamics of your pension plan
- ◆ Being in the defined benefit business is inherently risky

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YES, I WOULD DO IT  
AGAIN, BUT LET'S HOPE I  
DON'T HAVE TO!

